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Prices Unchanged in May, Down 0.9% from May 2008

1.(U) May CPI figures indicate that prices were unchanged from April, but were down 0.9% compared to May 2008. The decline represents the largest single-year price decrease in the CPI's history. The decline in the price level from a year ago, however, does not necessarily indicate deflation, because prices have been relatively flat over the last few months. Comment: The annual rate is expected to become even more negative in the next few months as prices are compared with their level in summer 2008, when oil prices peaked. (National Statistics Institute, 6/10)

Salgado Calls For Sharply Reduced GOS Spending in 2010

2.(U) Second Vice President Elena Salgado informed the Council of Ministers that the GOS will need to reduce central government nonfinancial spending by 4.5% between 2009 and 2010. If revenue and financing projections are accurate, this reduction would lead to a central government deficit of 5.7% of GDP and a total public sector deficit of 7.9%. According to Salgado, these deficits would put Spain on track to reduce the total public sector budget deficit to the 3% of GDP required by the EU by 2012. The revenue projections are based on the GOS' expectation that GDP will shrink by 3.6% in 2009 and 0.3% in 2010. (Presidency, 6/12)

Savings Bank Support Package Could be Ready This Month

3.(U) A nine-billion-euro savings bank ("caja") rescue fund that the GOS could leverage tenfold through borrowing guarantees could be ready this month, according to Second Vice President Salgado. The fund would finance recapitalizations and mergers and allow the Bank of Spain to take over cajas if necessary. The government has been discussing its plans with the opposition PP for several weeks, and the two sides are in agreement on several aspects, though differences remain. Salgado told the Financial Times she expects Spain to come out of the crisis with fewer but more solid banks and savings banks, and most observers assume that there will be several mergers of weak cajas in the coming year or two. Although the nonperforming loan ratio of

the cajas fell slightly in March to 4.78% of assets, this may be the result of cajas taking unsold real estate in order to avoid recognizing as nonperforming their loans to troubled construction companies and developers. Even the two largest banks, Santander and BBVA, which are expected to gain market share, are reducing staff and branches. (El Mundo, 6/8; Financial Times, 6/11-12)

GOS Submits to Congress Bill Implementing EU Services Directive

4.(U) The Council of Ministers approved on June 12 for submission to Congress a proposed "Omnibus Law" that would partially implement the EU services directive. The law, which would modify 47 laws, will be treated with urgency, as the EU requires that the directive be implemented by the end of the year. It would liberalize many activities, make it easier to start businesses, and remove requirements for previous registration/authorization by the government in a wide range of services. A Ministry of Economy and Finance study estimated implementation would increase competition, boosting GDP by 1.2% and creating 150,000 to 200,000 jobs. The service sector currently accounts for two-thirds of Spain's jobs and GDP. A framework law for the directive is already in Congress. For the directive to be fully implemented, the Congress also will need to implement a controversial commerce reform, not yet proposed by the GOS, that would include reductions in restrictions on store hours of operation. (El Pais, 6/12; Expansion, 6/12; Presidency, 6/12)

CHACON